Supreme Court, U.S.
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82-1471

No. _____

In The

Supreme Court of the United States

October Term, 1982

—o—

THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Petitioner,

vs.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA, AND HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION

Respondents.

—o—

APPENDIX

—o—

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APPENDIX A

No. 81-528

IN THE SUPREME COURT OF THE
STATE OF MONTANA

1982

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
A Federally Chartered Association et al.,
Plaintiffs and Appellants,

vs.

DEPARTMENT OF REVENUE et al.,
Defendants and Respondents.

Appeal from: District Court of the First Judicial District,
In and for the County of Lewis and Clark,
Honorable Gordon Bennett, Judge presiding

Counsel of Record:

For Appellants:

Cannon and Sheehy, Helena, Montana
Edmund F. Sheehy Jr. argued, Helena, Montana

For Respondents:

Michael J. Rieley argued, Helena, Montana

Submitted: June 28, 1982
Decided: September 23, 1982

Filed: Sept. 23, 1982

/s/ THOMAS J. KEARNEY
Thomas J. Kearney
Clerk

Honorable Joel G. Roth, District Judge, delivered the Opinion of the Court.

First Federal Savings and Loan Association of Missoula (Missoula First Federal) and Havre Federal Savings and Loan Association (Havre Federal) (hereinafter also referred to as the "taxpayers") appeal from a summary judgment granted to the Department of Revenue (Department) by the District Court of Lewis and Clark County. We reverse.

Missoula First Federal and Havre Federal are federally chartered savings and loan associations doing business in the State of Montana. As such, they are subject to the Montana Corporation License Tax pursuant to the provisions of section 15-31-101(4), MCA. The Department of Revenue is the state agency responsible for the administration and collection of the Montana Corporation License Tax pursuant to section 15-31-111, MCA.

These two taxpayers are required annually to pay to the state treasurer 6¾ percent of their respective net incomes as a license fee for the privilege of carrying on business in Montana. See sections 15-31-121 and 15-31-101(3), MCA. Each of these taxpayers filed its Montana Corporation License Tax return for the calendar tax year of 1979.

In order to arrive at the net income upon which the tax is based, each taxpayer had deducted from its gross income the interest income it had received from its investments in several federal obligations. Additionally, Havre Federal deducted a net operating loss from prior years which was carried over to 1979.

After the Department of Revenue received the tax returns for 1979 and examined same, the Department disallowed the deduction for interest income on federal obligations on each tax return and also disallowed the deduction of the net operating loss carryover on Havre

Federal's return. The Department computed that Missoula First Federal owed an additional license tax of $12,271.00 plus interest and Havre Federal owed an additional license tax of $47,010.78 plus interest. A notice of the disallowances and resulting tax deficiencies was sent to each taxpayer.

Each taxpayer filed a written protest pursuant to section 15-31-503, MCA, with the Department and when the Department refused to reconsider its position, the two taxpayers joined together and filed a declaratory judgment action against the Department on November 12, 1980, in the District Court of Lewis and Clark County, seeking a judicial interpretation of the several state and federal statutes involved plus a judgment declaring part of one state statute relating to the calculation of net operating loss carryovers to be unconstitutional because of its retroactive application.

Because only questions of law were raised by the allegations in the complaint and answer, the taxpayers filed their motion for summary judgment on April 3, 1981. Subsequently, the Department filed its motion for summary judgment. Written memoranda were filed by both sides and oral argument was presented on May 28, 1981. The District Court granted the Department's motion, denied the taxpayers' motion and issued a summary judgment with a memorandum decision on August 19, 1981.

The effect of the District Court's summary judgment was that the interest income from the federal obligations was not deductible from gross income in arriving at taxable net income, that the net operating loss incurred in prior years could not be carried over and deducted in 1979 by Havre Federal and that the state statutory provision relating to net operating loss carryovers did not violate the constitutional prohibition against retroactive application of a state statute. It is from that summary

judgment and the order denying the taxpayer's motion for summary judgment that the taxpayers appeal, raising the following three issues for appellate review:

First Issue: Did the District Corut err by deciding that interest income from certain federal obligations is includable in net income and hence subject to the Montana Corporation License Tax? We hold there was error on this issue.

Second Issue: Did the District Court err in deciding that the Montana Corporation License Tax is not discriminatory? We hold that this issue is moot in view of our decision on the first issue.

Third Issue: Did the District Court err in deciding that section 15-31-114(2)(b)(ii)(C), MCA, is not constitutionally retroactive? We hold there was error on this issue.

FIRST ISSUE

The taxpayers contend the following interest income from the federal obligations indicated is exempt from the Montana Corporation License Tax:

FEDERAL OBLIGATION	INTEREST INCOME
U.S. Treasury Bills	$ 3,843.65
Federal Home Loan Bank Notes	38,120.61
Federal Land Bank Obligations	118,325.70
Federal Farm Credit Bank Securities	4,695.82
Federal Home Loan Bank Dividends on Stocks	48,013.00
Federal Savings and Loan Insurance Corporation—30% of Insurance Premium and Partial Payback	8,475.00

The District Court, in holding that the interest income from the federal obligations was includable in net income

for purposes of calculating the Montana Corporation License Tax, cited and relied on a federal statute, 31 U.S.C. § 742 (1976), which provides as follows:

> "Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

The District Court reasoned that the exception stated in the above federal statute applied to the Montana Corporation License Tax, which is admitted by the parties herein to be a franchise tax, and hence the interest income from the federal obligations is includable in the net income which is the basis upon which the license tax is computed.

The taxpayers had unsuccessfully contended in the District Court that the specific federal statutes which created the federal obligations and authorized their issuance expressly exempted both the principal and the interest paid thereon from all state taxation except estate and gift taxes. The federal statutes which created the federal obligations involved herein, authorized their issuance and contain the exemption are 12 U.S.C. § 1433 (1976), 12 U.S.C. § 1725(e) (1976), 12 U.S.C. § 2055 (1976), 12 U.S.C. § 2079 (1976), 12 U.S.C. § 2134 (1976) and 31 U.S.C. § 769 (1976). Those federal statutes expressly provide that the principal and interest of the various federal obligations are exempt from all state taxation except certain taxes not relevant herein.

The Department argued that the Montana Corporation License Tax is a franchise tax on the *privilege* of doing

business in Montana with the tax based upon or measured by the net income of the taxpayer. Hence, it was argued, that the tax is not on the property (interest income) but is on the privilege. This Court finds the argument to be unpersuasive. It is a distinction without a difference in our opinion. If the franchise tax is on the privilege and the tax is based on the net income, this Court concludes that the tax is on the privilege *and* the net income. If the net income includes tax-exempt interest, the tax is on exempt income which is prohibited by the specific federal statutes creating the federal obligations and granting the tax exemption. The Montana Supreme Court held in 1976 in the case of Security Bank v. Connors and Colbo (1976), 170 Mont. 59, 550 P.2d 1313, that the Montana Corporation License Tax is a tax on net income. It also appears to this Court that by the Department's including the tax-exempt interest in net income, the Department is seeking to tax indirectly what it cannot tax directly, in violation of the general rule set forth in 31 U.S.C. § 742 (1976). See, Federal Products Corp. v. Norberg (R.I. 1981), 429 A.2d 447.

In the *Federal Products Corp.* case, a Rhode Island industrial corporation had invested cash in federal obligations which were exempt from state taxes. The corporation was subject to the Rhode Island Business Corporation Tax, which was not a franchise tax but rather was a tax on the net income of the corporation. The corporation had deducted the interest income from its gross receipts in arriving at the net income subject to the state tax. The tax administrator refused to allow the deduction and included the interest income in the corporation's taxable net income. The lower court affirmed the tax administrator but, on appeal to the Rhode Island Supreme Court, the interest income from the federal obligations was held to be exempt from the state tax. The decision emphasizes that the tax

administrator was attempting to do *indirectly* what he could not do directly, i.e., levy a state tax on interest income from federal obligations when the federal obligations and the interest therefrom were expressly declared to be exempt from state taxation pursuant to 31 U.S.C. § 742 (1976). The Rhode Island Supreme Court said that although the tax administrator contended that he included the interest income merely as a measure to determine the corporate income tax due to the state, he overlooked the fact that the amount of the tax assessed was increased by more than $11,000.00 by the inclusion of the tax-exempt interest from the tax-exempt federal obligations in the measure of the tax. That court concluded by saying that the only conclusion to draw is that the state tax was an *indirect* tax on exempt federal obligations and their interest and hence invalid.

During oral argument on this appeal, the taxpayers' counsel orally cited the recent Tennessee case of Memphis Bank and Trust Co. v. Garner (Tenn. 1981), 624 S.W.2d 551, as a case found after the briefs on appeal were filed. That case is contrary to the taxpayers' position herein. That case involved a local bank excise tax which was computed on the bank's net earnings which included interest from tax-exempt federal obligations. The Tennessee Supreme Court said there was nothing in the general federal exemption statute (31 U.S.C. § 742 (1976)) or in the particular federal exemption statutes pertaining to the federal obligations involved that prohibited the state from measuring the bank excise tax on net earnings which included interest on federal obligations. Counsel stated that the case has been appealed to the United States Supreme Court and certiorari has been granted. We disagree with the Tennessee court. It is our opinion that both the general federal exemption statute and the individual particular federal exemption statutes clearly exempt the interest

income of the federal obligations involved in the instant case from the Montana Corporation License Tax.

In summary on the first issue, we hold that the District Court erred and that the interest income received by the taxpayers on the exempt federal obligations is not includable in net income for the purpose of calculating the Montana Corporation License Tax.

SECOND ISSUE

Since we decided that the interest income from the tax-exempt federal obligations involved herein is not includable in net income for the purpose of computing the Montana Corporation License Tax, the second issue becomes moot.

THIRD ISSUE

The District Court held there was no unconstitutional retroactive application of section 15-31-114(2)(b)(ii)(C), MCA, to Havre Federal's 1979 tax return. Havre Federal had incurred a net operating loss in each of the five years from 1974 through 1978. Those losses occurred because, prior to 1979, interest income from federal obligations was not subject to the Montana Corporation License Tax because interest income from state obligations was specifically exempt from said tax. Hence, when Havre Federal deducted the federal interest income from gross income in arriving at net income on its tax returns for those earlier years, a net operating loss resulted.

Section 15-31-114(2)(b)(i), MCA, provides for the carrying forward of net operating losses. Under that statute Havre Federal carried forward its net operating losses from 1974 through 1978 and applied same to its 1979 return which resulted in no net income for 1979. It is to be noted that Havre Federal computed its net operating losses in 1974 through 1978 pursuant to the Montana Corporation License Tax statutes *then in effect.*

Section 15-31-114(2)(b)(ii)(C), MCA, provides:

> "Any net operating loss carried over to any taxable years beginning after December 31, 1978, must be calculated under the provisions of this section effective for the taxable year for which the return claiming the net operating loss carryover is filed."

The Department, acting under the authority of the above-quoted statute, recalculated the net income of Havre Federal for the years 1974 through 1978 based upon the 1979 law, which resulted in the adding back of the deducted federal interest income in each of the earlier years which further resulted in the elimination of the net operating losses for each of the earlier years. Hence, there were no operating losses to carry forward to 1979.

It seems clear to this Court that the retroactive application of a 1979 law to the years 1974 through 1978 is unconstitutional. Havre Federal made investment decisions and financial plans based on the tax laws in effect in the years involved. The state cannot change a law in 1979 and compel a recalculation of tax returns filed for 1974 through 1978 based upon the new law effective for the first time in 1979.

This Court stated in the case of Castles v. State ex rel. Department of Highways (1980), ____Mont.____, 609 P.2d 1223, 1225, 37 St.Rep. 734, 736:

> "A retroactive law is one that takes away or impairs vested rights acquired under existing laws or creates new obligations or imposes new duties in respect to transactions already past."

We conclude that section 15-31-114(2)(b)(ii)(C), MCA, is unconstitutional because it requires retroactive application, it is in violation of the due process clause of the federal and state constitutions, and it imposes a new duty on Havre Federal.

CONCLUSION

We reverse the District Court's order denying the taxpayers' motion for summary judgment and reverse the District Court's order granting the Department's motion for summary judgment and remand this case to the District Court for the purpose of entering new orders and summary judgment in conformance with this decision.

/s/ JOEL G. ROTH
Honorable Joel G. Roth, District Judge,
sitting in place of Mr. Justice Fred J. Weber

We concur:

/s/ FRANK I. HASWELL
Chief Justice

/s/ GENE B. DALY
/s/ JOHN CONWAY HARRISON
/s/ DANIEL J. SHEA
/s/ FRANK B. MORRISON, JR.
Justices

/s/ W. W. LESSLEY
Honorable W. W. Lessley, District Judge,
sitting in place of Mr. Justice John C. Sheehy

IN THE SUPREME COURT OF THE
STATE OF MONTANA

No. 81-528

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION
OF MISSOULA, a Federally Chartered Association,
and
HAVRE FEDERAL SAVINGS & LOAN ASSOCIATION,
a Federally Chartered Association,
Plaintiffs and Appellants,

v.

DEPARTMENT OF REVENUE, State of Montana,
Defendant and Respondent.

ORDER

PER CURIAM:

The petition for rehearing is denied.

DATED this 6th day of December, 1982.

/s/ FRANK I. HASWELL
Chief Justice

/s/ GENE B. DALY
/s/ FRANK B. MORRISON, JR.
Justices

/s/ JOEL G. ROTH
Honorable Joel G. Roth, District Judge,
sitting in place of Mr. Justice Fred J. Weber

/s/ W. W. LESSLEY
Honorable W. W. Lessley, District Judge,
sitting in place of Mr. Justice John C. Sheehy

Mr. Justice John Conway Harrison and Mr. Justice Daniel J. Shea would grant a rehearing.

Filed: December 6, 1982

/s/ THOMAS J. KEARNEY
Clerk of Supreme Court
State of Montana

Filed: December 8, 1982

/s/ MARY G. HARRIS

APPENDIX B

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS & CLARK.

FIRST FEDERAL SAVINGS & LOAN OF MISSOULA ASSOCIATION, A Federally Chartered Association,
and
HAVRE FEDERAL SAVINGS & LOAN ASSOCIATION, a Federally Chartered Association,
Plaintiffs,

vs.

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, an Administrative Agency within the Executive Branch of State Government,
Defendant.

No. 45982

MEMORANDUM AND ORDER

Filed: August 19

Nancy Jones

The complaint in this action was filed November 12, 1980. Defendant answered January 5, 1981. April 3rd the plaintiffs filed a motion for summary judgment. The defendant filed a cross motion for summary judgment May 15th. The matter was argued and briefed and is submitted for decision. There are no disputed facts.

Plaintiffs are taxpayers and are subject to the Montana corporation license tax provided for in Title 15 Chapter 31, MCA. The Department of Revenue is the Department responsible for administration and collection of the tax. In their tax returns for 1979, both plaintiffs deducted interest

income from certain federal obligations from gross income to arrive at net income. In the same returns, plaintiff Havre Federal Savings & Loan applied carryovers from net operating losses incurred in prior years; it carried these amounts over to 1979 without using the method of calculating net operating losses effective for the tax year in question in accordance with Section 15-31-114(2)(ii)(c) MCA (as amended in 1979). The Department disallowed the interest income deductions of both plaintiffs and the net operating loss deduction of Havre Federal Savings & Loan. Missoula First Federal Savings & Loan received a notice of tax deficiency for $12,271.00 plus interest of $108.93 for the 1979 tax year. Havre Federal Savings & Loan received a notice of tax deficiency of $47,010.78 plus interest of $1,135.98 for the 1979 tax year. Both plaintiffs filed written protests with the Department and instituted this action.

The issues presented are as follows:

I. Whether interest income from certain federal obligations, listed in Exhibit A, are includable in the computation of corporation license tax.

II. Whether the Montana corporation license tax is discriminatory.

III. Whether Section 15-31-114(2)(ii)(c) is unconstitutionally retroactive.

I.

Interest income from federal securities which are tax-exempt under those specific statutes listed in Exhibit A are includable in the computation of the Montana corporation license tax. 31 USCA §742 reads:

> All stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require

> that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, *except nondiscriminatory franchise or other non-property taxes in lieu thereof imposed on corporations* and except estate taxes or inheritances taxes. (emphasis added)

Plaintiffs assert the tax-exempt obligations in Exhibit A are not affected by the above statute, and thus their interest income cannot be included in the computation of corporation license tax under Sections 15-31-101 et seq., MCA. They contend the federal statute applies only to obligations which are not specifically exempted from taxation, as the obligations in Exhibit A are; in other words, the express exemption from taxation of these obligations excludes them from coverage of §742. The issue then is statutory construction and determination of legislative intent.

The first sentence of §742 has been in existence since 1862. The second sentence was added in 1959. Thus before 1959 the federal statute did not expressly exclude franchise taxes from the general tax immunity granted federal obligations and securities. However, despite lack of express provision by statute, the United States Supreme Court traditionally and consistently held that interest and income from tax exempt securities and obligations may be included in computation of franchise and excise taxes without violating constitutional or statutory prohibitions against their taxation. In so holding, the Court held, in effect, that use of the tax exempt securities and obligations as a measurement for franchise and excise taxes is not a "tax" on the securities and obligations, rather it is a tax on the corporate franchise, with reference being made to the obligations, for the sole purpose of determining the amount of tax to be exacted each year. Any inclusion of tax exempt property is "incidental" and not the focus of

the tax. *Home Ins. Co. of New York v. People of the State of New York*, 33 L. Ed. 1025 (1889); *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1910); *Pacific Co. v. Johnson*, 285 U.S. 480 (1932); *Tradesmen's National Bank v. Okla. Tax Commission*, 309 U.S. 560 (1939). In *Northwestern Mutual Life Ins. Co. v. Wisconsin*, 275 U.S. 136 (1927), the Court made a distinction between a franchise tax and a property tax based upon the difference between taxation on gross income, in which event the tax would be deemed to be directly on the income of the federal obligation, and taxation on the net income, in which event the tax would be deemed a measuring device for determination of the franchise tax. In *Macallen Co. v. Massachusetts*, 279 U.S. 620 (1929), the Court, while recognizing that excise taxes generally could be measured by tax exempt securities, emphasized that inclusion of tax exempt property is legitimate as long as "the thing taxed in form was in fact and reality the subject aimed at," and struck down a Massachusetts tax statute declaring that the taxation policies embodied in that state's statutes clearly intended the tax to be for the very purpose of subjecting the tax-exempt securities to the burden of the tax from which they were immune. The Montana Supreme Court in *Montana Bank v. Casey*, 135 Mont. 104, 337 P2d 935 (1959), noted the authority of the legislature to include interest on federal obligations in the corporation's net income in computing the license tax.

When Congress amended §742 in 1959, it intended to clarify, and not to change, the existing law, in two respects: (1) That the tax immunity include indirect as well as direct taxation (see *Montana Bankers' Association v. Montana Department of Revenue*, 117 Mont. 112, 580 P2d 909 (1978); and (2) the immunity does not include

nondiscriminatory franchise and other nonproperty taxes.[1]

To address the individual exemption statutes in Exhibit A, we first note that there are no cases which declare any of these as being outside the scope of 31 USCA §742.

12 USCA §1433 was enacted in 1932 and amended in 1935. It states in pertinent part:

> Any and all notes, debentures, bonds and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority;

12 USCA §1725(e) was enacted in 1934. It states in pertinent part:

> (e) All notes, bonds, debentures, or other such obligations issued by the Corporation shall be exempt, both as to principal and interest, from all taxation (except surtaxes,

---

[1] See 1959 U.S. Code Congressional and Administrative News, wherein the analysis of the amendment to 31 USCA §742, the Senate report stated, on p. 2777:

"Under the amendment, a new sentence is added to section 3701. The new sentence makes it clear that the exemption now provided by section 3701 extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporation taxes and except estate taxes or inheritance taxes."

> estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The Corporation, including its franchise, capital, reserves, surplus, and income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority;

31 USCA §769 was enacted in 1910. It exempted obligations (issued after 1910) from federal and state taxation. This statute was partially repealed by 31 USCA §742(a), in 1941, which made federal obligations issued after 1941 subject to federal taxation.

§742 as amended in 1959 must be interpreted to govern the securities and obligations whose immunities are created by the above, pre 1959, statutes. It expressly refers to *all* stocks, bonds, treasury notes, and other obligations of the United States. The plain and obvious meaning of the language of a statute must be used, if possible, to determine legislative intent. *National Forest Preservation Group v. Volpe*, 352 F.Supp 123, motion den. 359 F.Supp 136 (D.C. Mont. 1972). Congress is presumed to be cognizant of its earlier enactments. *Texaco, Inc., v. Fed. Power Comm'n.*, 317 F2d 796 (C.A. Okla, 1963) cert. den. 377 U.S. 922; *U.S. v. Hawkins*, 228 F2d 517 (C.A. Alaska 1956).

12 USCA Sections 2055, 2079 and 2134 were all enacted in 1971. 12 USCA §2055, provides:

> Every Federal land bank and every Federal land bank association and the capital, reserves, and surplus thereof, and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation, except taxes on real estate held by a Federal land bank or a Federal land bank association to the same extent, according to its

value, as other similar property held by other persons is taxed. The mortgages held by the Federal land banks and the notes, bonds, debentures, and other obligations issued by the banks or associations shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt act of 1941 (section 742(a)[1] of Title 31).

12 USCA §2079, provides:

Every Federal intermediate credit bank and the capital, reserves, and surplus thereof and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation except taxes on real estate held by a Federal intermediate credit bank to the same extent, according to its value, as other similar property held by other persons is taxed. The obligations held by the Federal intermediate credit banks and the notes, bonds, debentures, and other obligations issued by the banks shall be deemed to be instrumentalities of the Government of the United States, and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (section 742(a)[1] of Title 31).

12 USCA §2134, provides:

Each bank for cooperatives and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such bank shall be exempt, both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority. Such banks, their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United

States or by any State, territorial, or local taxing authority; except that interest on the obligations of such banks shall be subject only to Federal income taxation in the hands of the holder thereof pursuant to the Public Debt Act of 1941 (section 742(a)[1] of Title 31) and except that any real and tangible personal property of such banks shall be subject to Federal, State, territorial, and local taxation to the same extent as similar property is taxed.

None of these sections expressly or impliedly contradict or repeal §742 as amended in 1959. Nor do they depart particularly from the language used in tax statutes which have been judicially interpreted not to preclude use of tax exempt obligations and securities in franchise taxes. Again, when Congress enacted these 1971 statutes it is presumed to have known its prior enactments and the judicial interpretations thereof. To support this proposition in fact, we note the House report's analysis of §2055: "The existing law relating to the tax status of land banks and associations is reenacted by this section . . . ." 1971 *U.S. Code Congressional and Administrative News*, 2107.

As to §2079, the same report stated on page 2109: "The tax status of the Federal intermediate credit banks is stated separately in this section and is identical in substance with the present law." As to §2134, it stated on page 2113: "The tax status of the banks for cooperatives under existing law is reenacted." The existing laws referred to did not differ from or contradict 12 USCA §742 or existing judicial interpretation of the tax law in regard to franchise taxes.

For the above reasons we conclude the legislature is not prohibited from including interest income from the obligations listed in Exhibit A in determining corporation license taxes.

II.

The Montana corporation license tax is not discriminatory. Plaintiffs contend it is because the statutes do not permit the Department to include interest income from state obligations in its computation while interest income from federal obligations can be included.

Section 15-31-112 provides: "The license fee shall be computed on the basis of the corporation's total net income for the taxable period." The net income is the gross income minus specified deductions. "Gross income" means "all income recognized in determining the corporation's gross income for federal income tax purposes but shall include interest exempt from federal income tax." 15-31-113(1). This language clearly permits the inclusion of all interest income in the computation of gross income. The plaintiffs assert that the specific state obligations listed in the attached Exhibit B expressly exempt these obligations from any taxation, including the license tax. The tax exemption provisions in the statutes listed in Exhibit B are all substantially the same. For example: 90-6-125 provides that the obligations, their transfer and income ". . . shall be free from taxation by the state. . . ." Other statutes declare that the obligations are "exempt" or "free" from all state taxation.

We first note there is no case law interpreting any of the statutes listed in Exhibit B with respect to their immunity from corporation license tax. The Montana Supreme Court has never had occasion to interpret any of Montana's tax exemption statutes to preclude the use of those obligations in the computation of license or excise taxes. It has, as previously noted, recognized the federal interpretation of federal tax law to permit the use of tax exempt obligations in computing franchise taxes. *Montana Bank v. Casey*, supra. The term "exempt from taxation"

has acquired, through decades of judicial interpretation a peculiar legal meaning; according to that meaning tax-exempt obligations and securities can be used as a measure for computation of franchise taxes. Because neither Montana's legislature not its Supreme Court has expressed anything to the contrary with respect to tax immunity of state obligations, this Court is obliged to apply the same construction to the statutes presently in issue. 1-2-106 MCA; *State Dept. of Highways v. Public Employees Craft Council of Mont.*, 165 Mont. 349, 529 P2d 785. We therefore conclude that the state obligations in the statutes listed in Exhibit B are includable in the computation of gross income for corporation license tax under Section 15-31-113 MCA.

III.

Section 15-31-114(2)(ii)(C) is not unconstitutionally retroactive. That subsection reads:

> "Any net operating loss carried over to any taxable years beginning after December 31, 1978, must be calculated under the provisions of this section effective for the taxable year for which the return claiming the net operating loss carryover is filed."

Before December 31, 1978, interest income from state and federal obligations were deducted from the corporation's gross income for computation of license tax. State law was amended in 1979 to allow inclusion of interest income from state and federal obligations in net income for the purpose of calculating the corporation license tax. The corporation's net income is thus greater if computed under the 1979 law than under prior law. In order to apply 15-31-114(2)(ii)(C) to the corporation's losses carried over from prior years, the Department had to recompute the net income from the prior years according to the 1979 law: the once exempt obligations had to be added back into net income. After recomputing the income for those

prior years, the Department found that there were no losses to be carried over into 1979, and therefore disallowed the loss carryover deduction claimed by the plaintiff for 1979. The Department assessed deficiencies for 1979, but not for the previous years.

It is within the constitutional power of the legislature to enact or amend statutes to apply retroactively as long as they do not impair obligations of contract or disturb vested rights. The legislature may change the mode of collecting taxes which have already been assessed at any time before they have been paid or otherwise discharged. There is no vested right in a mode of procedure for collecting taxes. *O'Brien v. Ross*, 144 Mont. 115, 393 P2d 1013 (1964); *Snow's Mobile Homes, Inc. v. Morgan*, Wash. 494 P2d 216 (1972). No person has a vested right to have a law unchanged for his benefit. *Lines v. City of Topeka*, Kan. 577 P2d 412 (1978); *Seattle First Nat. Bank v. Shoreline Concrete Co.*, Wash. 588 P2d 1308 (1978). A taxpayer has no vested right to have his current taxes computed on the same basis as prior taxes have been. *Filoli, Inc., v. Johnson*, Cal. 51 P2d 1093 (1935). The computation of a franchise tax for a given year can be measured by transactions and income of prior years. *State v. J. C. Maguire Construction Co.*, 113 Mont. 324, 125 P2d 433 (1942); *Filoli, Inc. v. Johnson*, supra; *Title Ins. & Trust Co. v. Franchise Tax Bd.* Cal. 302 P2d 79 (1956). It is the general rule, and not an exception, with regard to availability of loss carryback and carryover, that the loss is treated as though it occurred in the year to which it is to be carried. *Christian v. Dept. of Rev.*, Or. 526 P2d 538 (1974), and cases cited therein. Thus, so long as the recalculation of prior years' net income is not used to retax the corporation for those previous years, that is to say, the new computation is applied prospectively, the tax is not unconstitutional.

Plaintiffs argue that they accrued a vested right at the time their losses were incurred, that right being the use of the existing statute allowing them to carry over their net losses for seven years. The net losses were required to be carried back one year at a time for three years, then carried forward one year at a time for seven years until the losses were used up. Each year to which the loss was applied could use only enough of the loss until the net income for that year equalled zero. (ARM 42.23.411 et seq., provides a more understandable explanation of this procedure than the language in Section 15-31-114 MCA). Thus in order to take advantage of the loss carryback and carryover in any given year, the corporation must have a net profit for that year. It is thus apparent that the use of loss carryback and carryover for losses incurred in a given year is *contingent* upon the corporation's future income. A right is not vested if it is qualified by contingencies. *Robert v. Ellis*, Or. 368 P2d 342 (1962); *State v. Estes Corp.*, Ariz. 558 P2d 714 (1976); *Christian v. County of Ontario*, N.Y. 399 NYS2d 379 (1977).

We therefore conclude Section 15-31-114(2)(ii)(C) is not unconstitutionally retroactive on its face or in its application to plaintiffs.

Plaintiffs' motion for summary judgment is DENIED; defendant's cross-motion for summary judgment is GRANTED.

Dated this 19th day of August, 1981.

GORDON R. BENNETT
District Judge

cc to:

Cannon Law Office
2031 Eleventh Avenue, Helena, Mt.,

Dept. of Revenue, Legal Division
Mitchell Building, Helena, Mt.,

EXHIBIT A

Security	Interest Earned	Statute Conferring Tax Exempt Status
U.S. Treasury Bills	$3,843.65	31 U.S.C. Section 769
Federal Home Loan Bank Notes	$38,120.61	12 U.S.C. section 1433
Federal Land Bank Obligations	$118,325.70	12 U.S.C. section 2055
Federal Farm Credit Bank Security	$4,695.82	12 U.S.C. sections 2079 and 2134
Federal Home Loan Bank Dividends on Stock	$48,013.00	12 U.S.C. section 2134
Federal Savings and Loan Insurance Corporation 30% of Insurance Premium and Partial Payback	$8,475.00	12 U.S.C. section 1725(e)

EXHIBIT B

a. Board of Housing Bonds (Section 90-6-125, MCA);

b. Municipal Refunding Revenue Bonds (Section 7-7-4605, MCA);

c. Airport Authority Revenue Bonds (Section 67-11-303, MCA);

d. Railroad and Rehabilitation Bonds (Section 60-11-1109, MCA);

e. Railroad Rolling Stock Revenue Bonds (Section 60-11-1203, MCA);

f. Urban Renewal Bonds (Section 7-15-4302, MCA);

g. County Water and Sewer District Bonds (Section 7-13-2329, MCA);

h. Municipal Parking Commission Revenue Bonds (Section 7-14-4646, MCA);

i. Bonds for Financing County Hospitals and Nursing Homes (Section 7-34-2411, MCA).

3. That the matters and things set forth above are true and correct to the best of his knowledge and belief.

FURTHER AFFIANT SAYETH NOT.

DEPARTMENT OF REVENUE
Corporation Tax Division
Mitchell Building
Helena, Montana 59620

/s/ GERALD L. FOSTER
Gerald L. Foster
Administrator

State of Montana)
County of Lewis and Clark) ss.

On this 13th day of May, 1981, before me a Notary Public for the State of Montana, personally appeared

Gerald L. Foster known to me to be the person whose name is subscribed to the within instrument and acknowledged to me that he executed the same in his capacity as Administrator of the Corporation Tax Division of the Department of Revenue of the State of Montana and also in his capacity as a private individual.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Official Seal the day and year in this certificate above written.

/s/Raini Williams
NOTARY PUBLIC for the
State of Montana
Residing at Clancy
My Commission Expires:
October 30, 1983

(SEAL)

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

No. 45982

FIRST FEDERAL SAVINGS & LOAN OF MISSOULA ASSOCIATION, a Federally Chartered Association,
and
HAVRE FEDERAL SAVINGS & LOAN ASSOCIATION, a Federally Chartered Association,
Plaintiffs,

vs

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, an Administrative Agency within the Executive Branch of State Government,
Defendant.

NOTICE OF ENTRY OF JUDGMENT

TO: Edmund F. Sheehy, Jr.
Cannon, Parrish and Sheehy
2031 Eleventh Avenue
Helena, Montana 59601

PLEASE TAKE NOTICE pursuant to Rule 77(d), Montana Rules of Civil Procedure, that the enclosed document is a true copy of the Order of the Court and Memorandum entered in the above-captioned matter on the 19th day of August, 1981.

DATED this 25 day of August, 1981.

CLARA GILREATH,
Clerk of District Court

Filed: Aug. 25, 1981

/s/ Hilda Funk
Deputy Clerk

APPENDIX C

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

Cause No. 45982

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA, A Federally Chartered Association,
and
HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION, A Federally Chartered Association,
Plaintiffs,

v

DEPARTMENT OF REVENUE, State of Montana, an administrative agency within the Executive Branch of state government,
Defendant.

ORDER AND JUDGMENT

Filed: Dec. 20, 1982

Mary Root

On September 23, 1982, the Montana Supreme Court reversed this Court's memorandum and order of August 19, 1981, granting summary judgment to the Department of Revenue herein and the Supreme Court directed that a new order and summary judgment be entered in this cause, in accordance with the opinion of the Montana Supreme Court. Thereafter, the Court on December 6, 1982, denied the Department of Revenue's petition for rehearing and remittitur was issued to this Court.

NOW THEREFORE, based on the Opinion of the Montana Supreme Court;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. Plaintiffs' motion for summary judgment is hereby granted and the Department's cross-motion for summary judgment is denied;

2. That the interest income from the federal obligations held by plaintiffs, which are: Federal Home Loan Bank Notes, Federal Land Bank Obligations, Federal Farm Credit Securities, Federal Home Loan Bank dividends on stock held by plaintiffs, Federal Savings and Loan Insurance Corporation obligations, and U.S. Treasury Bills are hereby declared to be exempt from taxation for purposes of the Montana Corporation License Tax because the federal statutes involved herein: 12 U.S.C. sections 1433, 2055, 2079, 2134, 1725(e) and 31 U.S.C. section 769 expressly provide that the interest income from these particular obligations is exempt from any form of state taxation which would and does include the Montana Corporation License Tax;

3. That the amendment to section 15-31-114(2)(b)(ii)(C), MCA, concerning the method of calculating net operating loss carry-over from prior years, is declared to be unconstitutional and void as violative of the due process clause of the both the United States Constitution and the Montana Constitution;

4. That defendant is hereby ordered to refund the illegal taxes collected in the sum of $12,379.93 to First Federal Savings and Loan Association of Missoula, who paid this amount under protest prior to the institution of this lawsuit and the sum of $48,146.76 to Havre Federal Savings and Loan Association, who paid this amount under protest prior to the institution of this lawsuit; and

5. That plaintiffs recover their costs incurred in this litigation.

DATED this 16th day of December, 1982.

GORDON R. BENNETT
District Judge

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

Cause No. 45982

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA, A Federally Chartered Association,
and
HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION, A Federally Chartered Association,

Plaintiffs,

v

DEPARTMENT OF REVENUE, State of Montana, an administrative agency within the Executive Branch of state government,
Defendant.

NOTICE OF ENTRY OF JUDGMENT

Please take notice that judgment was entered in the above entitled action in favor of the plaintiffs, a copy of which is attached hereto, on December 16, 1982.

DATED this 20 day of December, 1982.

CLARA GILREATH
Clerk of the District Court
First Judicial District
SEAL Lewis & Clark County, Montana
By /s/ Mary Root

CERTIFICATE OF SERVICE

This is to certify that the attached Notice of Entry of Judment was july served upon all parties of record by mailing a copy thereof, postage prepaid, to them or their attorneys at their addresses set forth below on the 20 day of December, 1982.

/s/ Mary Root

Michael J. Rieley, Esq.
Legal Bureau
Department of Revenue
Mitchell Building
Helena, MT 59620

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

No. 45982

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF MISSOULA, a Federally Chartered Association,
and
HAVRE FEDERAL SAVINGS & LOAN ASSOCIATION, a Federally Chartered Association,
Plaintiffs,

vs

DEPARTMENT OF REVENUE, State of Montana, an administrative agency within the Executive Branch of State Government,
Defendant.

ORDER

Filed: Dec. 30, 1982

/s/ Nancy Jones

This Court, upon Motion of Michael J. Rieley, an attorney for the Respondent, Montana Department of Revenue, having reviewed the authorities relevant thereto does hereby;

ORDER that entry of Final Judgment in this matter and any execution and enforcement thereon are hereby stayed pending application for Appeal or Writ of Certiorari to the Supreme Court of the United States with respect to the federal questions raised herein.

DATED this 29th day of December, 1982.

/s/ Gordon R. Bennett
District Judge

APPENDIX D

31 U.S.C. Section 769, UNITED STATES TREASURY BILLS

§769. Certificates of indebtedness; taxation; expense of issue

Any certificates of indebtedness hereafter issued [after February 4, 1910] shall be exempt from all taxes or duties of the United States (but, in the case of certificates issued after September first, nineteen hundred and seventeen, only if and to the extent provided in connection with the issue thereof), as well as from taxation in any form by or under State, municipal, or local authority; and a sum not exceeding one-tenth of one per centum of the amount of any certificates of indebtedness issued is hereby appropriated, out of any money in the Treasury not otherwise appropriated, to pay the expenses of preparing, advertising, and issuing the same.

12 U.S.C. Section 1433, FEDERAL HOME LOAN BANK NOTES

§1433. Exemption from taxation; obligations acceptable as credit on debt of home owner

Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that [in] any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the

same extent according to its value as other real property is taxed. The notes, debentures, and bonds issued at any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any home-owner debtor of such bank.

12 U.S.C. Section 1725(e), FEDERAL SAVINGS & LOAN INSURANCE CORPORATION NOTES

§1725. Creation of Federal Savings and Loan Insurance Corporation

* * *

(e) Taxation. All notes, bonds, debentures, or other such obligations issued by the Corporation shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality or local taxing authority. The Corporation, including its franchise, capital, reserves, surplus, and income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the Corporation shall be subject to State, territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed.

12 U.S.C. Section 2055, FEDERAL LAND BANK OBLIGATIONS

§2055. Taxation

Every Federal land bank and every Federal land bank association and the capital, reserves, and surplus thereof, and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation, except taxes on real estate held by a Federal land bank or a Federal land bank association to the same extent, according to its value, as other similar property held by other persons is taxed. The mortgages held by the Federal land banks

and the notes, bonds, debentures, and other obligations issued by the banks or associations shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (31 U.S.C. 742(a)).

12 U.S.C. Section 2079, FEDERAL FARM CREDIT BANK SECURITIES

§2079. Taxation

Every Federal intermediate credit bank and the capital, reserves, and surplus thereof and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation except taxes on real estate held by a Federal intermediate credit bank to the same extent, according to its value, as other similar property held by other persons is taxed. The obligations held by the Federal intermediate credit banks and the notes, bonds, debentures, and other obligations issued by the banks shall be deemed to be instrumentalities of the Government of the United States, and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (31 U.S.C. 742(a)).

12 U.S.C. Section 2134, FEDERAL HOME LOAN STOCK DIVIDENDS

§2134. Taxation

Each bank for cooperatives and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such bank shall be exempt, both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority. Such

banks, their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, territorial, or local taxing authority; except that interest on the obligations of such banks shall be subject only to Federal income taxation in the hands of the holder thereof pursuant to the Public Debt Act of 1941 (31 U.S.C. 742(a)) and except that any real and tangible personal property of such banks shall be subject to Federal, State, territorial, and local taxation to the same extent as similar property is taxed. The exemption provided in the preceding sentence shall apply only for any year or part thereof in which stock in the bank for cooperatives is held by the Governor of the Farm Credit Administration.

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT IN AND FOR THE STATE OF MONTANA, COUNTY OF LEWIS AND CLARK

Cause No. 45982

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA, A Federally Chartered Association,
and
HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION, Federally Chartered Association,
Plaintiffs,

vs

DEPARTMENT OF REVENUE, State of Montana, an administrative agency within the Executive Branch of state government.
Defendants.

COMPLAINT

GORDON R. BENNETT
Presiding Judge

Filed: Nov. 12, 1980

By /s/ Hilda Funk
Clerk of District Court

COMES NOW the plaintiffs and complain of defendant and allege:

1. Plaintiffs, FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA and HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION, are federally chartered savings and loan associations, doing business in the state of Montana.

2. Plaintiffs are subject to the Montana Corporation License Tax as set out in Title 15, Chapter 31, Parts 1 to 7, M.C.A.

3. Defendant, DEPARTMENT OF REVENUE, is the state agency responsible for the collection of the Montana Corporation License Tax.

4. Prior to the tax year beginning on or after December 31, 1978, plaintiffs in computing net income for purposes of the corporation license tax were allowed to deduct interest income from obligations of the state or any political subdivision or municipality of the state from gross income. Section 15-31-114(5), M.C.A. (1978).

5. As a result of this provision of state law, defendant promulgated and adopted a regulation allowing a deduction from gross income in computing net income for the corporation license tax of any interest income from obligations of the United States because federal law required interest income from these obligations to be treated the same as interest income from state obligations.

6. The federal law relied on by defendant in promulgating this regulation is 31 U.S.C. section 742, which provides that interest income on United States obligations is exempt from state taxation except nondiscriminatory franchise taxes. Since state law, until 1979, specifically exempted interest income from state obligations, a tax on interest income from United States obligations would have been discriminatory.

7. In 1979, the forty-sixth legislature of the state of Montana enacted House Bill 150, Chapter 634 of the Laws of Montana 1979. This act repealed the deduction from gross income in computing net income for the corporation license tax of interest income from obligations of the state or any political subdivision or municipality for tax years beginning on or after December 31, 1978.

8. By repealing this deduction, the legislature intended to authorize the inclusion of interest income from United States obligations as a part of gross income for purposes of

the corporation license tax because interest income from obligations of the state or any political subdivision thereof would now be taxable for purposes of the corporation license tax.

9. In enacting House Bill 150, Chapter 634 of the Laws of Montana 1979, the Montana Legislature amended section 15-31-114 (2) (b) (ii) (c), M.C.A., concerning the calculation of any net operating loss carryover to provide that for taxable years beginning after December 31, 1978, such net operating loss carryover from prior tax years must be calculated under the provisions of the Montana corporation license tax in effect for the taxable year for which the return claiming the net operating loss carryover is filed. This means that in computing a net operating loss carryover for tax years beginning after December 31, 1978, interest income from state and United States obligations must be added back to net income for the tax years prior to December 31, 1978 in which a net operating loss deduction was taken in order to determine whether there is any net operating loss then in those years to carryover.

10. In their tax returns for tax year 1979, plaintiffs deducted a part of their interest income from certain federal and/or state obligations from gross income to arrive at net income for purposes of the Montana corporation license tax. A list of the federal obligations held by plaintiff First Federal Savings and Loan Association of Missoula, and the interest income therefrom which it deducted from its gross income on its corporation license tax return for tax year 1979 is attached hereto as "Exibit A".

11. Plaintiffs, if they had a net operating loss from prior tax years, carried that amount over for tax year 1979 without recalculating the net operating loss for prior tax years as required by section 15-31-114 (2) (b) (ii) (c), M.C.A. A list of the amount of net operating loss carried

forward by plaintiff Havre Federal Savings and Loan Association is attached hereto as "Exhibit B".

12. Defendant, on or about June 24, 1980, issued a notice to plaintiff First Federal Savings and Loan Association of Missoula disallowing the deduction for interest income on United States obligations and notifying plaintiff of a resulting tax deficiency on its corporation license tax for tax year 1979 in the amount of $12,271.00 plus interest in the amount of $108.93.

13. Pursuant to section 15-31-503, M.C.A., on or about July 18, 1980, plaintiff First Federal Savings and Loan Association filed a written protest against this deficiency assesment with defendant. A copy of this protest is attached hereto as "Exhibit C".

14. Defendant, on or about August 27, 1980, issued a notice to plaintiff, Havre Federal Savings and Loan Association, disallowing its net operating loss deduction; deduction of interest income on United States obligations and deduction of interest income on Puerto Rico Bonds. Defendant notified this plaintiff of a resulting tax deficiency for tax year 1979 of $47,010.78 plus interest of $1,135.98.

15. Pursuant to section 15-31-503, M.C.A., plaintiff Havre Federal Savings and Loan Association filed a written protest against this deficiency assessment with defendant. A copy of this protest is attached hereto as "Exhibit D".

16. Plaintiffs contend that while 31 U.S.C. Section 742, as a general rule, authorizes the inclusion of interest income from United States obligations in the calculation of net income for purposes of a nondiscriminatory corporation license tax, this federal statute does not repeal, amend, nullify or control the specific federal statues relating to the federal securities listed on "Exhibit A"

wherein it is provided that the interest income from these securities is specifically exempted from any form of state taxation which would include corporation license taxes.

17. The federal statutes pertaining to the federal securities shown on "Exhibit A", being more specific than the general statute regarding state taxation of interest income from obligations of the United States must be, and are, controlling in determining whether the interest income from such securities is taxable.

18. Plaintiffs contend that House Bill 150, Chapter 634, Laws of Montana 1979, as codified in Title 15, Chapter 31, Parts 1 to 7, is a disciminatory franchise tax in that it attempts to tax all interest income received from United States obligations without taxing all interest income received from obligations of the state or any political subdivision thereof and is, therefore, illegal as being in direct violation of 31 U.S.C. section 742.

19. Plaintiffs contend that amendment made to section 15-31-114 (2) (b) (ii) (c), M.C.A., concerning the calculations of net operating losses for prior tax years is unconstitutional in that it amounts to the taking of a vested property right without due process of law and denies plaintiffs equal treatment under the law in violation of the United States Constitution and the 1972 Montana Constitution.

WHEREFORE, plaintiffs pray:

1. For a judgment declaring House Bill 150, Chapter 634, Laws of Montana 1979, now codified in Title 15, Chapter 31, Parts 1 to 7, M.C.A., illegal and void for amounting to a discriminatory franchise tax on the interest income of United States obligations in direct violation of 31 U.S.C. section 742;

2. For a judgment declaring the interest income from the federal securities shown on "Exhibit A" as being

specifically exempt from taxation for purposes of the Montana corporation license tax as set out in Title 15, Chapter 31, Parts 1 to 7, M.C.A.;

3. For a judgment declaring the amendment made to section 15-31-114 (2) (b) (ii) (c), M.C.A., concerning the method of calculating of net operating losses carried over from prior years to be unconstitutional and void;

4. For plaintiffs' costs herein, and,

5. For any other relief this court deems appropriate.

DATED this 12th day of November, 1980.

CANNON & GILLESPIE
2031 Eleventh Avenue
Helena, MT 59601

By /s/ ROSS W. CANNON
Ross W. Cannon

By /s/ EDMUND F. SHEEHY, JR.
Edmund F. Sheehy, Jr.
ATTORNEYS FOR PLAINTIFFS

EXHIBIT A

Security	Interest Earned	Statute Conferring Tax Exempt Status
U.S. Treasury Bills	$3,843.65	31 U.S.C. Section 769
Federal Home Loan Bank Notes	$38,120.61	12 U.S.C. section 1433
Federal Land Bank Obligations	$118,325.70	12 U.S.C. section 2055
Federal Farm Credit Bank Security	$4,695.82	12 U.S.C. sections 2079 and 2134
Federal Home Loan Bank Dividends on Stock	$48,013.00	12 U.S.C. section 2134
Federal Savings and Loan Insurance Corporation 30% of Insurance Premium and Partial Payback	$8,475.00	12 U.S.C. section 1725(e)

EXHIBIT B

HAVRE FEDERAL SAVINGS AND LOAN
Schedule of Montana Net Operating Losses
December 31, 1979

	Taxable Income Before NOL	Loss Carried Forward	Deduction Claimed Preceding yr.
1971	(45,791.97)		—0—
1972	12,157.43		—0—
1973	(35,303.15)		—0—
1974	(278,880.84)	(278,880.84)	—0—
1975	(278,778.76)	(278,778.76)	—0—
1976	(393,570.79)	(393,570.79)	—0—
1977	(451,453.74)	(451,453.74)	—0—
1978	(245,031.02)	(245,031.02)	—0—

NOL Carry Forward	(1,647,715.15)
NOL Used in 1979	418,890.45

EXHIBIT C

BEFORE THE DEPARTMENT OF REVENUE
STATE OF MONTANA

CORPORATION LICENSE TAX DEFICIENCY
NOTICE FOR FIRST FEDERAL SAVINGS AND
LOAN ASSOCIATION OF MISSOULA

PROTEST

COMES NOW, FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA (taxpayer) and pursuant to section 15-31-503, M.C.A., hereby protests the additional corporation license tax of $12,379.93 sought to be imposed against it by the Department of Revenue (Department) in its notice dated June 24, 1980.

The notice from the Department states that taxpayer owes $12,379.93 in taxes because the Department has included $200,205.00 in taxpayer's net income as interest income from United States obligations held by taxpayer. Taxpayer alleges that this $200,205.00 should not be included in its net income because this interest income is not taxable income.

While taxpayer admits that generally interest income from United States obligations is taxable for purposes of the Montana Corporation License Tax, the $200,205.00 in question here is not taxable income for purposes of the corporation license tax because the federal statutes creating and regulating the United States obligations held by taxpayer and in question herein expressly provide that the interest income from such obligations is exempt from any form of state taxation. Taxpayer contends that $200,205.00 in interest income, which the Department of Revenue seeks to tax, is interest income solely from United States obligations which had and have a specific exemp-

tion from state taxation under federal law. Therefore, taxpayer is not liable for any additional corporation license tax on this interest income which is not taxable.

Taxpayer hereby formally requests that the Department of Revenue grant it a hearing on this additional tax proposed to be assesesd and taxpayer's protest to such assessment.

DATED this 17th day of July, 1980.

/s/ PAUL J. CHUMRAU
Paul J. Chumrau
President of First
Federal Savings and Loan
Association of Missoula

EXHIBIT D

September 24, 1980

Mr. Gerald Foster,
Administrator, Corporate Tax Division
Department of Revenue
Mitchell Building
Helena, Montana 59601

Dear Mr. Foster:

RE: Havre Federal Savings and Loan Association — Deficiency Assessment for Tax Year Ending 12/31/79

This letter is written to officially file a written protest by taxpayer, Havre Federal Savings and Loan Association (hereinafter referred to as "Havre Federal") against the proposed additional tax set forth in the letter from the Department of Revenue to Havre Federal dated August 27, 1980, and accompanying documents from Candee B. Crantz. Havre Federal requests an oral hearing and an opportunity to present additional evidence relating to the referenced claimed tax liability. A copy of the letter sent by Candee B. Crantz and the determination of Montana corporate license tax prepared by her are attached hereto as Exhibit "A".

The grounds upon which this protest is based are as follows:

1. The Department of Revenue has disallowed a net operating loss in the amount of $418,890.48. This net operating loss was disallowed because of a change in Section 15-31-114, MCA, which now provides that a net operating loss carried over to 1979 must be calculated under the provisions regarding deductibility in effect for 1979. Havre Federal alleges that the application of this statute to itself is unlawful, unconstitutional and against public policy because:

(a) Havre Federal invested in securities which paid interest that was tax exempt under Montana law. These securities were purchased in reliance on this favorable tax treatment.

(b) The law in effect during the years in which net operating losses, which are now being redetermined, accrued allowed a reduction in taxable income for those taxpayers who had taxable income and a net operating loss for those taxpayers who did not have taxable income.

(c) For those taxpayers who had taxable income in previous years, the deduction stands unchanged by the recent legislation and the benefit of their previous investment in the securities of the type in question remains while those taxpayers who did not have taxable income were originally granted a tax benefit by a net operating loss carry back or carry forward which is now being disallowed.

The legislation as it effects this taxpayer is unlawful, unconstitutional and against public policy in that the taxpayer has relied upon the application of the deduction in making investments in previous years, the legislation is an ex post facto law and retroactively effects the taxability of the taxpayer's income for previous years. Thus, the legislation is an unconstitutional taking of a protected property right without due process of law under the constitutions of the United States and the State of Montana. The legislation as applied denies the taxpayer equal treatment with other taxpayers under the constitutions of the United States and the State of Montana.

For the above reasons the taxpayer respectfully requests that the Department of Revenue reconsider the proposed

assessment to allow the net operating loss to be carried forward as indicated on the taxpayer's return.

HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION

By /s/ EINAR LUND
Einar Lund
President

cc: Einar Lund

EXTRACT FROM REPLY BRIEF OF SAVINGS & LOAN ASSOCIATIONS TO THE SUPREME COURT OF MONTANA, pp. 3-4.

Defendant, in its memorandum in support of its cross-motion for summary judgment, discuss extensively whether the Montana Corporation License Tax is a franchise tax and whether the interest income from federal obligations can be included in the measure of this tax pursuant to 31 U.S.C. section 742. In making this argument, defendant is in no way advancing this litigation since on page 5 of Plaintiffs' memorandum, the following appears:

> "Plaintiffs agree that the Montana corporation license tax is a franchise tax. Plaintiffs further agree that interest income from federal obligations can be subjected to a non-discriminatory state franchise tax when, unlike the federal obligations in question here, there is no specific federal statute exempting the obligation and the income derived therefrom from taxation by the state. It is only where a federal statute specifically exempts the interest income from a particular federal obligation from state taxation that the plaintiff is authorized to deduct the interest income from taxation under the Montana corporation license tax . . ."

The issue here is not whether the Montana corporation license tax is a franchise tax or whether interest income from federal obligations may generally be included in the computation of such a tax; but, whether the interest income from the specific federal obligations at issue here is exempt from taxation by a state franchise tax. Thus both the Department and plaintiffs agree as to the type of tax being imposed and that interest income from federal obligations can generally be included in the measure of the tax.

EXTRACT FROM REPLY BRIEF OF SAVINGS & LOAN ASSOCIATIONS TO THE MONTANA DISTRICT COURT, p.2.

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IV.

REPLY ARGUMENT

THE DISTRICT COURT ERRED IN HOLDING THAT INTEREST INCOME FROM CERTAIN U.S. OBLIGATIONS HELD BY PLAINTIFFS IS INCLUDIBLE IN THE COMPUTATION OF THE MONTANA CORPORATION LICENSE TAX

In their brief, the Department devotes a substantial amount of space to argue that the Montana corporation license tax, section 15-31-101, et seq., MCA., is a franchise tax. The Department asserts that it is raising this argument because plaintiffs have "overlooked this point." In making this argument, the Department has totally misunderstood plaintiffs' position in this appeal and in this lawsuit. Plaintiffs have never contended and are not now contending that the Montana corporation license tax is anything other than a franchise tax. Plaintiffs' position is simply that the interest income from certain U.S. obligations held by plaintiffs is exempt from all state taxation including a franchise tax. See page 6 of the Appellant's Brief.

To argue that this interest income may be included in taxable income for purposes of the Montana corporation license tax, the Department relies upon a number of United States Supreme Court cases. The cases the Department cites in its brief are: *Flint v. Stone Tracy Company*, 220 U.S. 107, 31 S.Ct. 342, 55 L.Ed. 389 (1910); *Educational Films Corporation v. Ward*, 282 U.S. 379, 51 S.Ct. 170, 75 L.Ed. 400 (1931); *Pacific Co. v. Johnson*,

Section 7-7-4607, MONTANA CODE ANNOTATED, MUNICIPAL REFUNDING BONDS:

> **7-7-4607. Exemption from certain taxes for refunding revenue bonds.** The refunding bonds and the income therefrom shall be exempt from taxation except inheritance, estate, and transfer taxes.

Section 7-14-4654, MCA, MUNICIPAL PARKING COMMISSION REVENUE BONDS:

> **7-14-4654. Exemption from certain state taxes.** All such revenue bonds and the interest or income therefrom are exempt from all taxation in this state, other than gift, inheritance, and estate taxes.

Section 7-13-2330, MCA, COUNTY WATER & SEWER DISTRICT BONDS:

> **7-13-2330. Status of bonds — tax exemption.** Any bonds issued by any district organized under the provisions of this part and part 22 are hereby given the same force, value, and use as bonds issued by any municipality and shall be exempt from all taxation within the state of Montana.

Section 7-15-3407, MCA, URBAN RENEWAL BONDS:

7-15-4307. Tax exemption for bonds. Bonds issued under the provisions of this part and part 42 are declared to be issued for an essential public and governmental purpose and, together with interest thereon and income therefrom, shall be exempted from all taxes.

Section 7-34-2416, MCA, HOSPITAL & NURSING HOME BONDS:

> **7-34-2416. Tax-exempt status of bonds.** Bonds issued by a county pursuant to the provisions of 7-34-2411 through 7-34-2418 are declared to be issued for an essential public and governmental purpose by a political subdivision within the meaning of 15-30-111(2)(a).

Section 60-11-1110, MCA, RAILROAD REHABILITATION BONDS:

60-11-1110. Tax exemption. Bonds and refunding bonds, their transfer, and their income (including any profits made on their sale) are free from taxation by the state or any political subdivision or instrumentality of the state, except for inheritance and estate taxes.

Section 60-11-1210, MCA, RAILROAD ROLLING STOCK REVENUE BONDS:

60-11-1210. Tax exemption. Bonds and refunding bonds, their transfer, and their income (including any profits made on their sale) are free from taxation by the state or any political subdivision or instrumentality of the state, except for inheritance and estate taxes.

Section 67-11-306, MCA, AIRPORT AUTHORITY REVENUE BONDS:

67-11-306. Tax exemption. Any property in this state acquired by an authority for airport purposes, pursuant to the provisions of this chapter, and any income derived by the authority from the ownership, operation, or control thereof shall be exempt from taxation to the same extent as other property used for public purpose.

Section 90-6-125, MCA, BOARD OF HOUSING BONDS:

90-6-125. Tax exemption of bonds. Bonds, notes, or other obligations issued by the board under this part or by local housing authorities under Title 7, chapter 15, parts 21, 44 and 45, their transfer, and their income (including any profits made on their sale) shall be free from taxation by the state or any political subdivision or other instrumentality of the state, excepting inheritance, estate, and gift taxes. The board is not required to pay recording or transfer fees or taxes on instruments recorded by it.